



INFORMATION TECHNOLOGY SERVICES

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 30, 2006

Mr. Timothy Hugo
Executive Director
Free File Alliance, LLC
6350 Rolling Mills Place, Suite 102
Springfield, VA 22152

Dear Mr. Hugo:

I am writing in response to your request explaining how the level of coverage for services offered through the Free File program was determined by the IRS during the renewal process to extend the partnership agreement between the IRS and the Free File Alliance.

Overall, the Free File program was a resounding success in 2005. Last year, over five million federal returns were filed through the program at no cost to the taxpayer. This represented a 43 percent growth over the 2004 filing season. Another positive sign of the program's success was the reduction in the number of calls about program or vendor issues to the IRS from taxpayers.

As this was the final year of the agreement, the IRS needed to consider how best to proceed to maintain and grow this important program. One major concern was the overall health of the online and self-prepared market segment. In 2005, 75 percent of the e-file growth in this segment could be attributed to the Free File program. If this trend continued, the IRS was concerned that it could cause many vendors to go out of business, innovation to be dramatically reduced or cease entirely, and investment in this segment to diminish or end. Industry analysts stated in their filing season reports that Free File represented a threat to future revenues and profits of the publicly traded company participants. After careful consideration, it became clear that we needed to pursue the following policy during the renewal process:

- Maximize Free File program availability to the taxpayer while maintaining the health and viability of the online and self-prepared tax software market segment, and
- Focus on product and service quality, offer clarity and security.

In order to maintain the viability of the free file program, IRS proposed to limit companies to income ranges that represent 70 percent or 75 percent or less of the individual taxpayer population. This represented an adjusted gross income (AGI) of approximately \$50,000 and \$60,000 respectively based on current information. Even with these limitations, more than 90 million taxpayers will be eligible to participate in this program. The Free File Alliance agreed to the IRS' proposal to provide guaranteed

coverage to 70 percent of taxpayers. In October 2005, the IRS and the Free File Alliance agreed to a four-year term extending its partnership to provide free federal online tax preparation and e-file services to eligible taxpayers.

I hope this information is helpful. If you need further assistance, please contact Kim McDonald, Acting Director, Strategic Services Division, at (202) 283-4790.

Sincerely,



Bert W. DuMars
Director, Electronic Tax Administration

cc: Mr. Stephen M. Ryan, Counsel to the Free File Alliance